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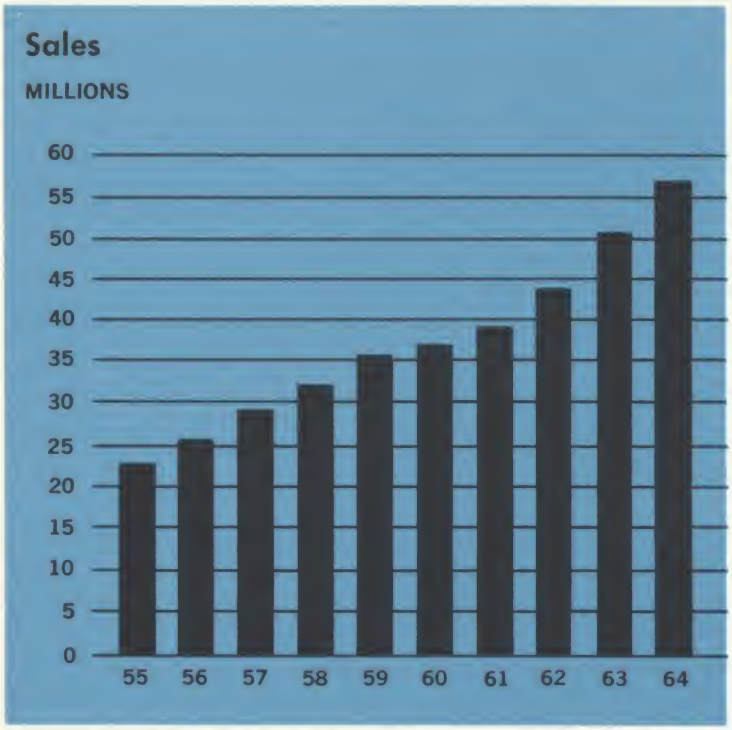
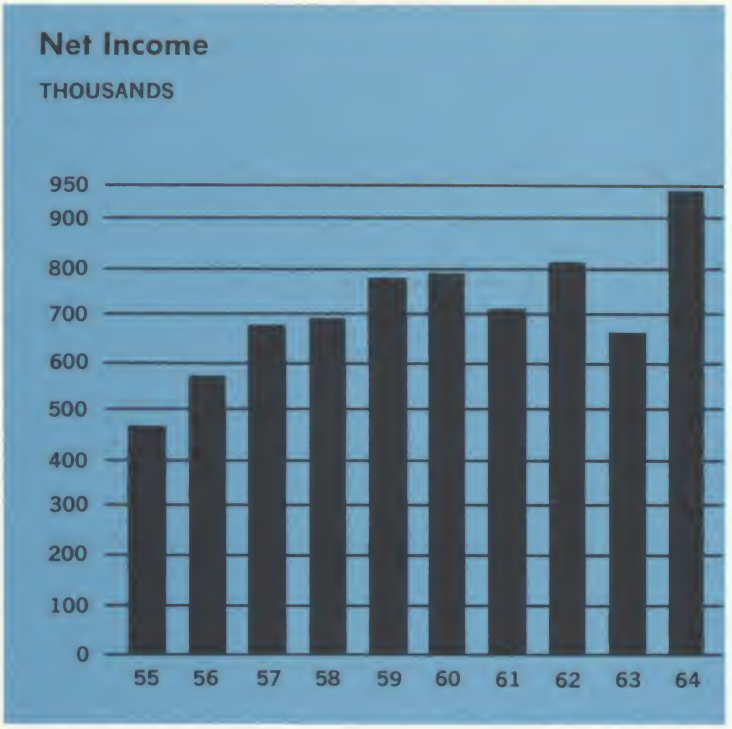
GRAY DRUG STORES, INC., 1964 ANNUAL REPORT

Cosmetic department in one of our conventional drug stores is shown in top photo. Middle photo shows a drug center typical of those operated by our King Division in discount department stores. Crowd at opening of a junior department store operated by our newly acquired Rink's Division is shown in lower photo.





Highlights of Operations

FISCAL YEARS ENDED JUNE 30	1964	1963
Net Sales	$57,320,337	$51,875,334
Net Income	$ 946,404	$ 662,366
Net Income Per Share	$ 1.50	$ 1.05
Dividends Per Share	$ .80	$ .80
Working Capital	$12,132,632	$11,692,984
Current Ratio	2.77 to 1	3.08 to 1
Shareholders Equity	$10,783,652	$10,340,971
Number of Stores and Discount Drug Centers	151	152

151 Drug Stores and Leased Departments

Years Ended June 30	New Stores and Discount Drug Centers	Stores Remodelled And Enlarged	Stores and Discount Drug Centers Closed or Sold	Total Stores and Discount Drug Centers
1960	9	14	2	111
1961	14	11	8	117
1962	22	14	5	134
1963	28	13	10	152
1964	18	30	19	151

12 new openings are already scheduled for this year; 24 drug stores will be remodelled; and the Rink's chain of six junior department stores (page 9) has been added to our operation.

Mr. Weinberger

Mr. Evans

LETTER TO SHAREHOLDERS

The rapid growth of Gray Drug Stores, Inc., continued during the fiscal year ended June 30, 1964, and net income also climbed to a new record, rising at an even faster pace than sales. In addition, a major acquisition was completed after July 1, 1964, and will contribute to further very substantial progress during the fiscal year now under way.

Net sales during the past year totalled $57,320,337, a gain of 10 per cent over the $51,875,334 of the preceding year. This was the 14th consecutive year in which volume increased.

Net income of $946,404 was up 43 per cent over the $662,366 earned during the preceding year. This was a return of 1.65 per cent on sales compared with 1.28 per cent a year ago, and surpassed the previous peak of $801,113 reached two years ago in fiscal 1962.

Per share earnings of $1.50 compared with $1.05 for the preceding year.

The financial condition of Gray Drug Stores, Inc., remains excellent. Working capital reached a new record of $12,132,632 at the fiscal year-end, with current assets of $18,971,818 in a ratio of 2.77 to 1 to current liabilities of $6,839,186. Shareholders equity also reached a new high of $10,783,652 or $17.13 a share.

At the fiscal year-end, the Company was operating a total of 151 conventional drug stores, discount drug stores, and discount drug centers in discount department stores.

Current Business Trends

The increase in net income during the past year was the result of several important trends:

1. Sales per store in our conventional drug store operations, after remaining relatively static for the first six months of the year, were up sharply for the second half as compared to the preceding year.

2. Retail price competition remained intense, but not quite to the same degree as a year ago, and customers tended to upgrade their purchases.

3. Six regular drug stores and 13 discount units operating on a marginal basis were closed or sold. Three new drug stores and 15 discount units, all of which we believe have a good profit potential, were opened during the year.

4. Remodeling of 30 drug stores and discount units was carried out to attract more traffic and improve profit margins.

5. A carefully planned profit control program was in effect throughout the year and proved highly successful.

6. Our prescription activity, which is basic to our operations, continued to increase in line with long-term trends.

Prescription Operations

Gray Drug, throughout its 36-year history, has emphasized the highest possible quality of service in its ethical pharmaceutical departments. This combination of service and value, plus the national trend toward greater use of prescriptions, has led to large increases in our prescription volume.

A total of 2,959,223 prescriptions were dispensed during the past year, an increase of 23 per cent over the preceding year and well over twice the number for 1960. Dollar volume of prescriptions was $9,187,613 during the past year, a gain of 25 per cent over the previous year.

The percentage of refill prescriptions, reflecting our competitive prices and the introduction of such new drugs as tranquilizers, has also increased steadily year after year and refills now account for nearly half of all our prescriptions. Of course, the customers who return to Gray stores time and time again for prescription refills also make a habit of buying many other products from us.

We now have approximately 350 "men in white," all graduate pharmacists headed by a Manager of Prescription Operations who is currently also a member of the Ohio State Board of Pharmacy. In addition, several of our top executives, including the founder, are pharmacists.

Our stores, including discount units, have men available to compound prescriptions at all times. We stock slow-moving as well as fast-moving items . . . over 2500 pharmaceuticals in each prescription department, so that we can serve the needs of virtually all customers.

Our pharmaceuticals are always fresh, purchased from the nation's most reputable manufacturers and each of our prescription departments is a clean, bright, modern drug laboratory, well-lighted with an open layout tailored to permit courteous personal service. Unexcelled professional service is a primary objective of Gray Drug Stores, and a primary source of our strength.

A New Dimension

Gray Drug three years ago established its first discount drug departments in discount drug stores, a diversification move that has been very successful and accounted for 33 per cent of our volume last year.

We now have undertaken another far-reaching diversification step by entering the junior department store field through acquisition of the Rink's Department Stores chain, which owns six full-line stores and operates leased soft goods departments in four others.

Rink's is a pioneer in the field, with proved merchandising skills, and is expected to add $12,000,000 to Gray Drug sales during the current fiscal year. This acquisition became effective July 1, 1964, and was made for $1,027,500 cash and 30,000 common shares, plus additional cash payments based on Rink's net income during the next four years. We anticipate that it will add about 30 cents a share to earnings during the current fiscal year.

Plans call for the opening of new Rink's department stores on a continuing basis, and each of these will feature a leased drug department operated by our King Division. A more detailed outline of Rink's operations and plans will be found elsewhere in this report.

Dividend Policy

Four quarterly dividends of 20 cents each, a total of 80 cents, were paid during the past year. A dividend has been paid in each year since the Company was organized in 1928.

Current Outlook

Gray Drug is made up of experienced and capable people, and has management depth in all major departments. Our organization has met the challenge presented by a period of intense competitive pressure, and the Company has become larger, more profitable, and stronger than ever before.

All of the growth and profit improvement trends evident during the past year are continuing to develop. A number of new store and discount unit openings are planned for the current year. At the same time, the Rink's acquisition adds a substantial new source of sales and earnings to our operations.

Sales during the current year are expected to be in excess of $70,000,000, strengthening our already commanding position as the leading drug chain in Ohio and adjacent areas. Net income and earnings per share, on the basis of present trends, are expected to more than keep pace with the increase in volume.

Sincerely,

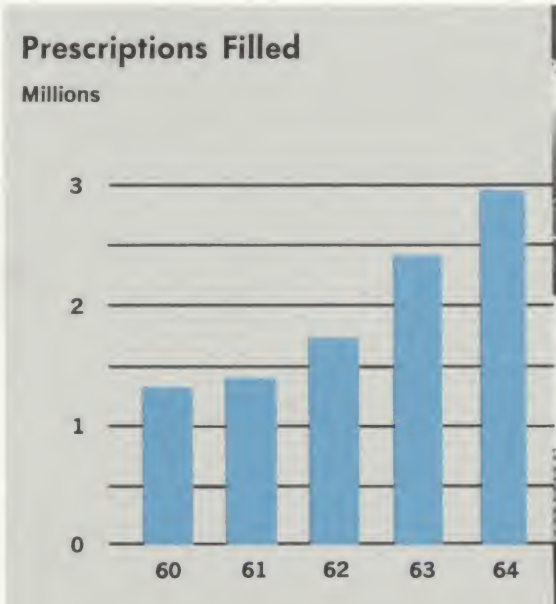
Adolph Weinberger

Adolph Weinberger, Chairman

Carlyle W. Evans

Carlyle W. Evans, President

September 9, 1964



Nearly 10,000,000 prescriptions have been filled during the past five years by the competent pharmacists who staff our large, attractive prescription departments.

Health section in one of our conventional drug stores. Note the display of products under our own brand name, reflecting a current trend in our operations.

THE GRAY DIVISION

106 Large Modern Drug Stores

The 106 conventional drug stores which make up our Gray Division rang up a total of 44,650,000 separate cash transactions last year, an average of more than 122,000 customers every day.

These are large and attractive stores. with the newer ones up to 12,000 square feet in size. Most of them are in shopping centers, About 25,000 items are stocked in a typical store. Decor is neat and attractive, and prices are highly competitive.

Nineteen stores were fully or partially remodeled during the past year and another 24 will be remodeled this year as part of a program already having an important impact on profit. In general, our purpose is to provide space for a product mix in which the most profitable departments are emphasized, and to improve store operating efficiency.

Prescription departments are being enlarged and better identified. We are putting a new emphasis on service-type cosmetic departments in self-service stores, with extensive lines of beauty treatment and fragrance products. Special sales training programs are being conducted for the personnel in these departments. Also, we are constantly testing new departments . . . laundry products, artificial flowers, hobby items such as stamp and coin albums, notions and sewing, to name a few.

Personal service of the type we can offer in prescriptions and cosmetics, plus extensive lines of well-known brand name products are difficult for stripped-down stores to provide, and give us a competitive advantage as well as a profitable product mix.

One of the major advances of the Gray Division has been introduction of a new store inventory control system worked out after careful study of our own operations and discussions with representatives of all other chain drug stores from coast to coast.

Basically, this involves a review of the annual movement of all merchandise in each store. After the necessary figures are provided by computer, maximum and minimum shelf inventory limits are established for each product according to actual past movement of merchandise, and this information then is coded for control of store ordering.

In stores tested so far, this system has increased sales by reducing out-of-stock conditions, since inventory is stored in the selling areas and is not allowed to fall below the specified minimums without reordering. Over-all inventory is reduced by eliminating slow items and preventing any build-up beyond actual store needs as proved by experience. Man-hours of non-productive work are saved in ordering, stocking and pricing procedures.

Another important new program has been the setting up of a school program for retraining of all present cashiers and indoctrination of new ones. This program helps to improve customer relations and at the same time contributes substantially to the efficiency and accuracy of check-out procedures and handling of money.

The Gray Division constantly seeks new store locations, and has become very selective in its choices, generally going only into the larger or regional type of shopping center, and making sure that it will support a high volume operation.

Six new stores are scheduled for opening this year. One is in the Northland shopping center at Columbus, Ohio, which opened in August and which is the largest shopping center in the city. Other large stores will be opened at Mansfield, Akron and Canton, Ohio, and at Hollywood and Dunedin, Florida. In downtown Cleveland, we will move out of an old store and into larger quarters in another building.

Strong promotion, improved merchandising techniques, and good general economic conditions have combined to improve sales per store, and higher sales plus closer control of expenses and more efficient operation have helped the Gray Division to improve profit margins materially. The new programs now under way are expected to maintain this trend during the current year.

Discount drug store operated by the King Division.

THE KING DIVISION

from an idea to $18,000,000 Volume in 3 Years

Our King Division, established in 1961 to take us into the discount drug field, reached a volume of $18,000,000 in the past year compared with $15,000,000 in the preceding year. The division on June 30, 1964, was operating 32 leased departments in discount department stores, 11 discount drug stores, and two union- sponsored prescription pharmacies . . . a total of 45 units.

Profit contribution of our discount drug operations has been substantially increased during the past year, and the King Division is in a strong position for continued growth.

It opened 15 discount units last year, remodeled 11 others, closed five and sold eight. About two-thirds of our discount operations now are in Ohio and adjacent states. These locations near our headquarters and warehouses mean that better controls can be maintained at less expense than a year ago, when many of our discount operations were widely scattered geographically.

Our discount drug operations are fast-moving and interesting. While sales of regular drug stores in a new shopping center build up gradually over a period of several years, we usually know within three months whether a discount operation will succeed. Investment in facilities is small, and profits begin almost immediately if the location is satisfactory. We either work on the basis of short-term leases or options to lease until we know results, so that marginal locations can be quickly dropped.

Our leased departments in discount department stores are usually from 3000 to 5000 square feet in size. Most of them offer complete drug and prescription facilities along with health and beauty aids, candy, school supplies and stationery, greeting cards, cigars and tobacco, photo developing and books.

Stocking of inventory on the sales floor, limitation of the number and sizes of items stocked, and maximum self-service features make very low prices possible for the customer's benefit. The operator of the store also benefits from our prescription experience, our ability to provide name brands that draw people into the store, and our general merchandising ability in the product lines we offer.

Our own discount drug stores, most of which are operated under the name "King Discount Drug Center," also are proving successful, and their number is being increased.

At least a half-dozen additional discount units will be opened this year, and the King Division looks to continued profit improvement as it grows. Its 400 employees have developed a fine know-how in the discount drug field, and an excellent reservoir of talent is available for our expansion.

Discount stores are gradually becoming junior department stores in every sense of the word. Marginal operators have largely dropped by the wayside, and the remaining stores are able to offer values that assure their place in the consumer merchandising field. To such stores, our King Division offers a highly specialized service which adds considerably to their own income. We anticipate continuing dynamic growth of our sales and income in the discount drug field.

Over 25,000 items are offered in our spacious, self-service conventional drug stores. This scene is from a new store at the largest shopping center in Columbus, Ohio.

Automatic photo developing equipment in Cleveland plant of Superior Laboratories Division.

THE SUPERIOR LABORATORIES DIVISION . . .

A Service "Plus" in Our Operations

The Superior Laboratories Division is a small but important part of Gray Drug Stores, Inc., helping us to provide good service and at the same time making a significant contribution to net income.

This division operates a 6000 square foot photographic developing plant in Cleveland, equipped for both color and black and white work, and a 5300 square foot black and white photographic development plant in Columbus.

It also operates a 6300 square foot laboratory in Cleveland which manufactures syrups for our food and soda fountain departments, packages prescription drugs and services and distributes to our stores TV tubes, radio and hearing aid batteries.

Having our own photo plants enables us to offer fast delivery of good quality photos at attractive prices in our drug store and discount center operations, and also helps us to earn a higher profit from photo developing than would otherwise be possible. About 50,000 rolls of film are developed a month. The Superior Laboratories Division also has a few outside customers in addition to our own stores. Laboratory facilities of this division enable us to buy drug and other products in large quantities at bulk prices, and save money by repackaging them ourselves for sale in our stores.

By providing services to our stores that we would otherwise have to buy on the outside, the Superior Laboratories Division has become an important "plus" in our operations, giving us a decided competitive advantage in many respects.

Right place to find a bargain! These are some of the hundreds of shoppers who flooded into the new Rink's Division junior department store at Florence, Ky., on opening day last month.

RINK'S DEPARTMENT STORES . . .

Put Us Into New Field of Great Promise

The acquisition of Rink's Department Stores means a major entry by Gray Drug into the junior department store field, and we foresee rapid expansion of the Rink's Division.

Hyman Ullner, 42-year-old president of Rink's, and his brother, Coleman, vice president, who is 44, believe that they were second in the nation to found a discount department store operation. Their organization is experienced and capable, with approximately 450 employees.

The two brothers, just out of the armed forces with $300 between them at the end of World War II, started a small war surplus business in Cincinnati, and opened their first general merchandise store in 1954 under the name of Famous Surplus Stores. In sharp contrast to today's modern Rink's stores, merchandise then was displayed on wooden tables or "anything we could put together." Everything was sold on a self-service basis, but product quality was high with a guarantee of "satisfaction or your money refunded."

The name, "discount store," had not yet been coined and the public was skeptical, but more and more people recognized that excellent bargains were being provided, and the store grew. Their second store was at Hamilton, Ohio, in a former skating rink, and this was the origin of the name, "Rink's." This store did $680,000 worth of business in its first year, and $1,100,000 the next.

Expansion has been steady ever since. Present facilities include a 50,000 square foot store in Hamilton; 60,000 square foot stores in Milford and Xenia, Ohio; a 107,000 square foot store reopened this summer in Evendale, a Cincinnati suburb, following a fire earlier this year; and a new 80,000 square foot store just opened at Florence, Ky. Another 80,000 square foot store is being opened this month at Dayton. Headquarters and a new warehouse are in Cincinnati.

Rink's has gradually upgraded all of its facilities until today all its stores are in new and modern buildings, brightly lighted with attractive fixtures and decor, and neat and extensive merchandise displays tailored for customer convenience. These are junior department stores of the highest type, rather than a chain of discount stores.

Rink's also operates leased soft goods departments in stores at Zanesville, Lima, Marion, and Bowling Green, Ohio.

The new Rink's Division has great strength in marketing and promotion, purchasing and merchandising. It has a successful formula all its own for profitable operation of junior department stores.

Emphasis is on providing the finest possible quality at the lowest possible prices, and the product lines are highly diversified . . . "virtually anything of quality that will hold up and can be guaranteed." An unusual degree of personal attention is provided to customers, and Rink's stores have built up a strong image with customers as places where they can buy with confidence.

Rink's believes it was the first junior department store to handle a complete line of boats, motors and trailers, and will do a $275,000 business in these this year. It was the first organization of its type to sell mobile homes, the first to have a beauty parlor and a barber shop. It has a larger power motor sales and service volume than anyone else in the Cincinnati area. The Evendale and Florence stores have large leased grocery and meat departments.

Other departments include men's wear, women's and children's apparel, shoes, hardware, automotive supplies, plumbing equipment, electrical parts, paint, housewares, sports goods, jewelry, domestic items, fabrics, pet supplies, snack bars, appliances, even a service station at one store. A few departments are leased to outside companies, including Gray Drug's King Division, which operates prescription, health and beauty aids departments at the Milford, Xenia, Evendale and Florence stores.

The Rink's Division is in a fine position for growth. Intensive television and newspaper advertising has made its name a byword in a large part of southern Ohio.

As an established, experienced organization in its field, it has for several years had an excellent training program, and has the reserves of management talent necessary for continuing progress.

It also has had a good profit record. During its fiscal year ended December 31, 1963, it earned approximately $200,000 on $8,000,000 in sales and has traditionally earned a return of from 2½ to 3½ per cent on sales. With one new store just opened, another reopened and a third due to be opened this month, volume during the current year is estimated at approximately $12,000,000.

The Rink's Division has an outstanding record and proved talents. To these Gray Drug is adding its extensive administrative facilities and financial resources. The junior or low-margin department store, in the hands of strong and experienced management, represents one of the most dynamic and promising fields in consumer merchandising today. We believe that the growth of the Rink's Division can be very substantial, and providing the back-up support needed for such progress is our objective at Gray Drug.

With the Rink's acquisition, Gray Drug Stores, Inc., has become a diversified organization active in five distinct and separate fields . . . conventional drug stores, discount drug stores, drug centers in discount department stores, photo developing and product packaging, and junior department stores. Each of these areas of operation is growing and creating new profit opportunities.

GRAY
DRUG STORES, INC.

CONSOLIDATED BALANCE SHEET

Assets

	June 30, 1964	June 30, 1963
CURRENT ASSETS		
Cash	$ 2,276,177	$ 1,945,073
United States Treasury Bills–at cost plus accrued interest	3,127,138	2,730,560
Accounts receivable, less allowance of $30,000	614,262	483,152
Inventories—priced generally on the basis of the lower of cost (latest) or replacement market	12,631,626	11,792,695
Prepaid expenses	322,615	374,278
TOTAL CURRENT ASSETS	$18,971,818	$17,325,758
OTHER ASSETS	87,630	99,035
FIXED ASSETS—on the basis of cost		
Furniture, fixtures, and equipment	$ 4,370,146	$ 4,353,377
Leasehold improvements	2,454,004	2,481,189
	$ 6,824,150	$ 6,834,566
Less allowances for depreciation and amortization	3,259,222	3,203,325
	$ 3,564,928	$ 3,631,241
DEFERRED DEBENTURE EXPENSE	139,762	147,711
	$22,764,138	$21,203,745

Gray Drug Stores, Inc. and Subsidiaries

Liabilities and Shareholders' Equity

	June 30, 1964	June 30, 1963
CURRENT LIABILITIES		
Trade accounts	$ 3,507,178	$ 2,743,830
Other liabilities and accrued expenses	1,827,728	1,722,313
Taxes other than federal taxes on income	312,933	292,305
Federal taxes on income—estimated	1,191,347	874,326
TOTAL CURRENT LIABILITIES	$ 6,839,186	$ 5,632,774
5% CONVERTIBLE SUBORDINATED DEBENTURES DUE 1982—Note A	5,141,300	5,230,000
SHAREHOLDERS' EQUITY		
Common Stock, par value $1 a share—Notes A and B:		
Authorized 1,000,000 shares Outstanding 629,654 shares	$ 629,654	$ 629,654
Capital in excess of par value	3,889,783	3,889,783
Earnings retained for use in the business—Note A	6,264,215	5,821,534
TOTAL SHAREHOLDERS' EQUITY	$10,783,652	$10,340,971
LONG-TERM LEASE COMMITMENTS—Note D		
	$22,764,138	$21,203,745

See notes to financial statements.

STATEMENT OF CONSOLIDATED INCOME AND EARNINGS RETAINED FOR USE IN THE BUSINESS

GRAY DRUG STORES, INC. AND SUBSIDIARIES

	Year Ended June 30, 1964	1963
Net sales	$57,320,337	$51,875,334
Other operating income	180,758	153,801
Other income	78,176	55,241
	$57,579,271	$52,084,376
Costs and expenses:		
Cost of goods sold	$38,387,054	$34,656,991
Selling, general, and administrative expenses	16,188,647	15,007,100
Depreciation and amortization	731,322	758,985
Interest expense	261,144	262,234
	$55,568,167	$50,685,310
INCOME BEFORE FEDERAL TAXES ON INCOME	$ 2,011,104	$ 1,399,066
Federal taxes on income—estimated	1,064,700	736,700
NET INCOME	$ 946,404	$ 662,366
Earnings retained for use in the business at beginning of year	5,821,534	5,662,891
	$ 6,767,938	$ 6,325,257
Cash dividends declared—$.80 a share—Note C	503,723	503,723
EARNINGS RETAINED FOR USE IN THE BUSINESS AT END OF YEAR	$ 6,264,215	$ 5,821,534

See notes to financial statements.

SUMMARY OF CONSOLIDATED SOURCE AND APPLICATION OF FUNDS

GRAY DRUG STORES, INC. AND SUBSIDIARIES

	Year Ended June 30, 1964	1963
SOURCE OF FUNDS		
From operations:		
Net income	$ 946,404	$ 662,366
Depreciation and amortization (including $7,949 of deferred debenture expense in 1964 and 1963), which did not involve working capital	739,271	766,933
TOTAL FROM OPERATIONS	$ 1,685,675	$ 1,429,299
Decrease in other assets	11,405	26,959
	$ 1,697,080	$ 1,456,258
APPLICATION OF FUNDS		
Expenditures for fixed assets	$ 665,009	$ 859,171
Cash dividends declared	503,723	503,723
Principal amount of 5% Convertible Subordinated Debentures purchased and held in treasury	88,700	- 0 -
Added to working capital	439,648	93,364
	$ 1,697,080	$ 1,456,258

NOTES TO FINANCIAL STATEMENTS

GRAY DRUG STORES, INC. AND SUBSIDIARIES

Year ended June 30, 1964

Note A—5% Convertible Subordinated Debentures:

The Indenture under which the Debentures were issued provides for sinking fund payments on or before January 25 in each year commencing in 1967, in an amount sufficient to redeem $285,000 principal amount of Debentures.

The Debentures are convertible into shares of Common Stock of the Company, at the option of the holder, at any time on or before February 1, 1982, at a conversion price (subject to adjustment in certain events) of $26 per share until February 1, 1967, $27 per share until February 1, 1972, and $28 per share thereafter until maturity. At June 30, 1964, 201,154 shares of Common Stock were reserved for conversion of the Debentures.

Under terms of the Indenture, earnings retained for use in the business in the amount of $1,959,344 at June 30, 1964, were available for distribution to shareholders.

The amount of Debentures outstanding at June 30, 1964, is after deducting Debentures in the amount of $88,700 held in the treasury.

Note B—Stock Options:

Stock options were granted on April 29, 1960, to certain officers and key employees to purchase 18,000 shares of Common Stock of the Company. The price at which the options were granted was the approximate quoted market price ($15.83) at the date of grant except that the option price to the principal shareholder and two employees related to him was 110% of such price ($17.42) to permit qualification as a restricted stock option. All the options became exercisable on April 29, 1962, and expire on April 29, 1965. During the year ended June 30, 1964, no options were exercised, and at June 30, 1964, options for 15,900 shares were outstanding.

Note C—Dividends:

The Company deposited funds with the dividend disbursing agent on June 29, 1964, for payment of the dividend payable July 1, 1964.

Note D—Long-Term Lease Commitments:

The companies are lessees under a number of leases extending from one to nineteen years. The annual aggregate minimum rental payable under such leases (many of which provide for additional rental if amounts based on specific percentages of sales exceed the minimum) amounted to approximately $1,950,000 at June 30, 1964.

Note E—Federal Taxes on Income:

The Internal Revenue Service has examined federal income tax returns of the companies for the three years ended June 30, 1962, and has proposed tax deficiencies resulting principally from the proposed disallowance of the surtax exemption for each of the subsidiary companies reporting taxable income for such years. The companies do not agree with the proposed deficiencies and have filed protests with the Internal Revenue Service in order to bring the matter before its Appellate Division. Settlement of this controversy is not expected to have a material effect on the consolidated financial statements.

Note F—Investment Tax Credit:

As a result of the enactment of the Revenue Act of 1964, the companies changed their accounting policy (adopted during the year ended June 30, 1963) of including the investment tax credit in income over the useful lives of the related assets and in the year ended June 30, 1964, included the full amount of the credit in income. The effect of such change upon net income for the year was not material.

Note G—Subsequent Event:

As of July 1, 1964, the Company acquired all of the outstanding stock of Rink's Department Stores, Inc., Hi-Code Trading Corporation, and Bargain City of Milford, Inc., for the sum of (1) $1,027,500 in cash, (2) 30,000 shares of its Common Stock, and (3) additional payments to be based on a net income of the acquired companies for a period of four years ending June 30, 1968.

Upon consolidation, the excess of the cost of investment over the book value of the stock acquired will be recorded as good will.

ACCOUNTANTS' REPORT

Board of Directors
Gray Drug Stores, Inc.
Cleveland, Ohio

We have examined the consolidated balance sheet of Gray Drug Stores, Inc. and subsidiaries as of June 30, 1964, the related statement of consolidated income and earnings retained for use in the business, and the summary of consolidated source and application of funds for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheet and statement of income and earnings retained for use in the business present fairly the consolidated financial position of Gray Drug Stores, Inc. and subsidiaries at June 30, 1964, and the consolidated results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. It is also our opinion that the accompanying summary of consolidated source and application of funds presents fairly the information therein shown.

Cleveland, Ohio
August 25, 1964

Ernst & Ernst

10 YEARS OF PROGRESS

	1964	1963	1962	1961	1960	1959	1958	1957	1956	1955
Net Sales	$57,320,337	$51,875,334	$44,952,417	$39,626,661	$37,552,700	$35,991,537	$32,249,706	$29,333,474	$25,543,059	$23,390,391
Net Income Before Federal Taxes on Income	$ 2,011,104	$ 1,399,066	$ 1,611,213	$ 1,467,793	$ 1,673,989	$ 1,607,591	$ 1,371,322	$ 1,404,880	$ 1,206,429	$ 953,560
Net Income	$ 946,404	$ 662,366	$ 801,113	$ 707,793	$ 793,989	$ 768,591	$ 692,322	$ 690,880	$ 576,429	$ 470,560
Income per Common Share (1)	$ 1.50	$ 1.05	$ 1.27	$ 1.42	$ 1.63	$ 1.58	$ 1.48	$ 1.47	$ 1.31	$ 1.07
Income as a Percentage of Sales	1.65%	1.28%	1.78%	1.78%	2.12%	2.14%	2.15%	2.36%	2.25%	2.01%
Income as a Percentage of Shareholders Equity	8.78%	6.41%	7.87%	9.04%	10.82%	11.20%	11.06%	11.95%	11.20%	9.94%
Cash Dividends Declared — Common Stock	$ 503,723	$ 503,723	$ 476,335	$ 393,062	$ 323,850	$ 256,720	$ 218,718	$ 208,928	$ 161,618	$ 145,893
Dividends Per Share (1)	$ .80	$ .80	$ .80	$ .80	$ .66⅔	$ .53⅓	$ .46⅔	$ .46⅔	$ .36⅔	$ .33⅓
Number of Shares Issued (1)	629,654	629,654	629,654	496,762	485,775	485,775	469,242	468,492	440,775	440,775
Net Working Capital	$12,132,632	$11,692,984	$11,599,620	$ 6,218,365	$ 6,087,245	$ 5,630,703	$ 3,691,958	$ 3,509,318	$ 3,389,227	$ 3,014,120
Total Assets	$22,764,138	$21,203,745	$20,296,698	$14,195,991	$14,114,536	$13,262,079	$11,195,293	$ 9,883,411	$ 9,069,108	$ 8,279,362
Long Term Debt	$ 5,141,300	$ 5,230,000	$ 5,230,000	$ 2,139,200	$ 2,313,500	$ 2,313,500	$ 531,426	$ 576,377	$ 758,554	$ 917,839
Shareholders Equity	$10,783,652	$10,340,971	$10,182,328	$ 7,826,699	$ 7,338,099	$ 6,867,960	$ 6,259,195	$ 5,781,497	$ 5,146,538	$ 4,731,727
Book Value per Share (1)	$ 17.13	$ 16.42	$ 16.17	$ 15.76	$ 15.11	$ 14.14	$ 13.34	$ 12.34	$ 11.68	$ 10.74
Fixture and Leasehold Additions	$ 813,084	$ 923,337	$ 713,221	$ 901,411	$ 748,758	$ 985,427	$ 903,700	$ 786,314	$ 467,887	$ 459,809
Depreciation	$ 731,322	$ 758,985	$ 667,295	$ 663,750	$ 633,483	$ 575,139	$ 507,717	$ 465,372	$ 451,573	$ 412,190
Units in Operation — End of Year	151	152	134	117	111	107	102	86	81	78

(1) Based upon the number of shares outstanding at the end of each year adjusted to reflect a stock split of 3 for 1 on September 30, 1960.

BOARD OF DIRECTORS

HAROLD C. BROWN	President, The Harold C. Brown Company
LLOYD C. DOUGLASS	Vice-President, Gray Drug Stores, Inc.
CARLYLE W. EVANS	President, Gray Drug Stores, Inc.
HENRY H. GRAY	Vice-President, Gray Drug Stores, Inc.
C. BERT McDONALD	Partner, McDonald & Company
GEORGE F. PRYOR	Personal Investments
JOHN W. REAVIS	Partner, Jones, Day, Cockley & Reavis
ADOLPH WEINBERGER	Chairman of the Board, Gray Drug Stores, Inc.
CARL WEINBERGER	Buyer, Gray Drug Stores, Inc.
JEROME WEINBERGER	Executive Vice-President, Gray Drug Stores, Inc.

OFFICERS

ADOLPH WEINBERGER	Chairman of the Board
CARLYLE W. EVANS	President
JEROME WEINBERGER	Executive Vice-President
LLOYD C. DOUGLASS	Vice-President
HERBERT H. DURR	Vice-President
HENRY H. GRAY	Vice-President
MARVIN L. KAHN	Vice-President
LOUIS BERWITT	Secretary
ROBERT E. BREIG	Treasurer
JOSEPH VALINS	Assistant Secretary
KENNETH FREY	Assistant Treasurer
I. ROSEN	President, Superior Laboratories, Inc.

TRANSFER AGENT AND REGISTRAR

THE CLEVELAND TRUST COMPANY — Cleveland, Ohio

AUDITORS

ERNST & ERNST — Cleveland, Ohio

COUNSEL

JONES, DAY, COCKLEY and REAVIS — Cleveland, Ohio

STOCK LISTED

MIDWEST STOCK EXCHANGE — Chicago, Illinois

MAIN OFFICE AND WAREHOUSE, 2400 Superior Ave., Cleveland 14, Ohio

GRAY
DRUG STORES, INC.